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In association with London Stock Exchange

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India Watch

Welcome to the Autumn edition of Grant Thornton's India Watch, in association with the London Stock Exchange

This quarter witnessed a general sell-off in emerging market equities along with Indian equities suffering further due to the country's large fiscal deficit, ineffective monetary policies and continuing political hurdles to implement structural reforms. Almost all constituents of the Grant Thornton India Watch Index were down. Overall, the index was down 3.4% against FTSE AIM All Cap Asean down 2.5% and FTSE 100 up 4%.

India M&A activity during this quarter nearly doubled compared to the same period last year; activity was driven by strong inbound cross-border M&A. In contrast, private equity activity during the quarter remained flat but deal values fared better compared to the same period in 2012.

India's economic woes continue to grow; the country's Sensex Index has seen significant volatility over the last quarter, the rupee has fallen as much as 20% and GDP growth is now only expected to reach 5.3% this year, down from its earlier projection of 6.4%. However, analysts aren't blaming all the rupee's decline on the country's economic performance and output, but on shifts in US monetary policy.

Our guest writer, Sandip Khroud of Irwin Mitchell, sets out some of the dos and don'ts when setting up Joint Ventures (JVs) in India. JV between UK and Indian companies can be the start of a successful entry into the Indian market but they can also be the beginning of a difficult journey if things go wrong.

Lastly, we review the key changes in the new India Companies Act 2013. The Act aims to improve corporate governance, simplify regulations, enhance the interests of minority investors and for the first time legislate the role of whistle-blowers. The Companies Act has the potential to affect UK companies with subsidiaries in India.

If you would like to discuss any of the matters arising in this issue or how Grant Thornton's South Asia group can help you please contact us.

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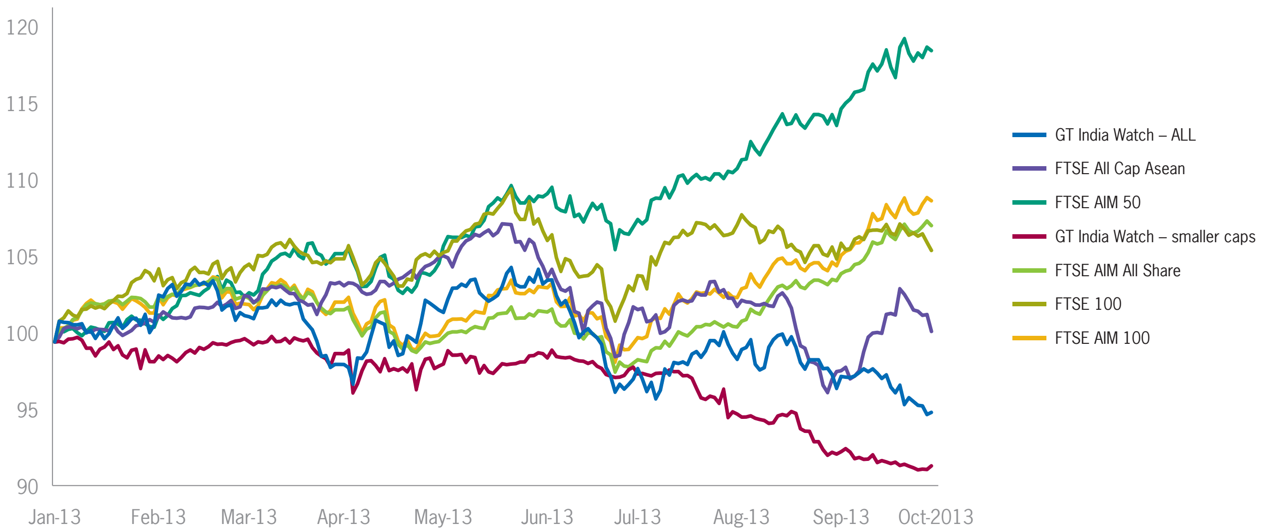
Equities suffer as the emerging markets' economic woes continue in Q3

Q3 witnessed a general sell-off in emerging market equities and Indian equities suffered further due to the country's large fiscal deficit, ineffective monetary policies and continuing political hurdles to implement structural reforms. Almost all constituents of the Grant Thornton India Watch Index were down. Overall, the index was down 3.4% against FTSE AIM All Cap Asean down 2.5% and FTSE 100 up 4%. This primarily reflects the general negative sentiment towards emerging market equities and investors' cautious approach towards Indian equities.



Source: Factset

Winners and losers in the quarter

The quarter went well for investors in Eros, with the stock being up 21%. The company reported a 145% increase in pre-tax profit in the quarter ended June 2013. Further, the stock was boosted by the announcement to list in the US markets to raise US$200 million to US$250 million.

The key losers were in the real estate, infrastructure and energy sectors. It appears that the investors were concerned about the impact of the state of the Indian economy on the wider infrastructure and energy sector.

In July 2013, KSK Power Ventures reported full year results for the year ended March 2013. The underlying revenue growth of 15% and gross profit growth of 35% compared to the previous year at the rupee level, has been strong given the current trading environment and increased generation levels over the year ended 31 March 2012. However, the currency depreciation of the Indian rupee against the US dollar of c.12%, since March 2012, led to reporting of more moderate revenue growth of 3% in US Dollar terms together with associated performance. The stock was down 43% in the quarter.

There was positive as well as negative news from Nandan Cleantec but overall the stock continued its decline into Q3 and was down 27.5%. In August 2013, the company announced that it has secured certification from the Environmental Protection Agency in the US and will start production from its facility in India to service orders from its US clients. However, in September 2013, Shapoorji Pallonji Agri Management announced it would leave the joint venture with Bharat Renewable Energy (BREL) – BREL was floated with state-run Bharat Petroleum Corporation (BPCL) and Nandan Cleantec.

Hirco was down 22% and it requested the suspension of trading of its shares as it awaits clarification over allegations about loans held by Indian project companies it works with.

Outlook

We remain positive on the long term outlook for Indian companies. We anticipate momentum in capital markets due to the proposed change in regulations allowing unlisted Indian companies, on a pilot basis, for a period of two years to list and raise capital abroad without the requirement of prior or subsequent listing in India. The short to medium term outlook though will depend on the wider state of the global economy, investor sentiment towards emerging markets and Indian government's ability to control the current account deficit and implement structural reforms.

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* The India Watch Index consists of 31 Indian companies listed on AIM or the Main Market (excluding GDRs). We only consider companies to be Indian if they are domiciled in India and/or foreign companies holding Indian assets or Investment companies with Indian promoters. The index has been created via Factset and is weighted by Market Value. To avoid distortion of index trends, the two largest market cap entities, Essar Energy and Vedanta Resource, are excluded.

** We have removed West Pioneer Properties Limited (got delisted) and Ishaan Real Estate (went into liquidation) from the Index.

Falling rupee triggers surge in India inbound investments

Overall M&A activity during Q3 2013 was nearly double compared to that seen during the same period last year; the activity was driven by strong cross-border inflows covering M&A and restructuring activity. The dominance of outbound deals during H1 was nearly reversed for the period to date with the strong resurgence in inbound activity including the restructuring deal involving Unliver's stake increase in its Indian subsidiary. Although the falling rupee, to an extent, appears to have neutralised the recent negative sentiment towards India, a clear outcome from the upcoming elections will be key to a longer-term reversal of fortunes.

Deal summary – Q3	Volume			Value (US$ billion)		
	2011	2012	2013	2011	2012	2013
Domestic	59	46	51	1.11	1.29	1.31
Cross Border	63	56	55	6.32	4.01	4.92
Mergers & Internal Restructuring	26	11	14	-	0.07	3.77
Total M&A	**148**	**113**	**120**	**7.43**	**5.37**	**10.00**
PE	90	92	113	1.87	2.25	2.10
Grand total	**238**	**205**	**233**	**9.30**	**7.63**	**12.10**
Cross Border includes						
Inbound	35	24	38	2.63	0.70	1.59
Outbound	28	32	17	3.69	3.32	3.33

Deal summary – YTD 2013	Volume			Value (US$ billion)		
	2011	2012	2013	2011	2012	2013
Domestic	148	178	168	4.51	4.42	4.44
Cross Border	208	180	169	32.79	9.12	15.24
Mergers & Internal Restructuring	105	80	40	-	14.62	4.27
Total M&A	**461**	**438**	**377**	**37.31**	**28.16**	**23.95**
PE	285	311	320	7.37	6.05	8.13
Grand total	**746**	**749**	**697**	**44.68**	**34.21**	**32.08**
Cross Border includes						
Inbound	93	100	103	23.12	3.67	5.70
Outbound	115	80	66	9.67	5.45	9.54

Top M&A deals* - YTD 2013

Acquirer	Target	Sector	US$ million	Deal type
ONGC Videsh Ltd	Rovuma Area 1 Offshore Block	Oil & Gas	2,640	Minority Stake
Apollo Tyres Ltd	Cooper Tire and Rubber Co	Automotive	2,500	Acquisition
Oil India Ltd, ONGC Videsh Ltd	Rovuma Area 1 Offshore Block	Oil & Gas	2,475	Minority Stake
Mylan Inc	Agila Specialties Pvt Ltd (Strides's injectable business)	Pharma, Healthcare & Biotech	1,800	Acquisition
UltraTech Cement Ltd	Jaypee Cement's 5 mtpa Gujarat facility	Cement	590	Majority Stake
Cipla Ltd	Cipla Medpro	Pharma, Healthcare & Biotech	512	Acquisition
FPM Power Holdings Ltd	GMR Energy (Singapore) Pte Ltd	Power & Energy	482	Majority Stake
Emerson Group	Virgo Valves & Controls Ltd	Manufacturing	450	Acquisition
NTPC Ltd	Nabinagar Power Generating Company Pvt Ltd	Power & Energy	413	Strategic Stake
Etihad Airways	Jet Airways	Aviation	379	Strategic Stake

*excluding internal mergers and restructuring deals

Deal summary: YTD 2013

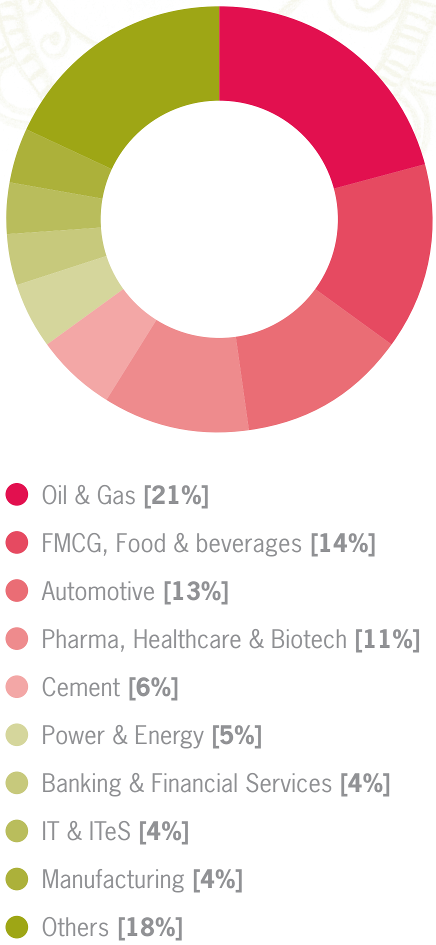
The Indian M&A market showed moderate levels of deal activity in the first nine months of 2013 with 377 deals amounting to US$23.9 billion. YTD 2013 recorded the lowest first nine month deal values and volumes since 2010. However, excluding internal mergers and restructuring deals, YTD 2013 M&A deal values clocked up a sequential increase of 45% from the same period in 2012. The quarter saw M&A deal values at twice the Q3 2012 levels driven by a surge in restructuring deal activity and inbound M&A, with domestic and outbound activity remaining flat.

Topping the list was the internal restructuring deal (and therefore not included in the M&A deal chart above) involving stake increase in Hindustan Unilever for US$3.1 billion by Anglo-Dutch parent Unilever, followed by ONGC's Rovuma oil block acquisitions for over US$2.5 billion each and Apollo Tyres's US$2.50 billion acquisition of Cooper Tire and Rubber Co. Unilever's open offer was the largest such deal in the history of India's capital markets.

Africa and North America contributed 40% and 38% respectively towards total cross-border deal values during the nine months of 2013. However, Europe saw the most number of announced transactions with 67 deals followed by North America with 50 deals.

The sector that continues to see strong M&A activity over the past few quarters is pharma, as drug deficit in the global pharmaceutical industry (mainly US) continues to drive pharma M&A in Indian companies, especially involving those with USFDA (US Food and Drug Administration) approved facilities. The drying up of the R&D pipeline globally coupled with the expected patent cliff in the US drug market in the next two to three years and a constant pressure on manufacturing cost reduction will make India a sought after manufacturing destination. The period also saw a surge in interest in the auto ancillary space, which is otherwise not a sector that is high on the agenda for M&A or PE activity.

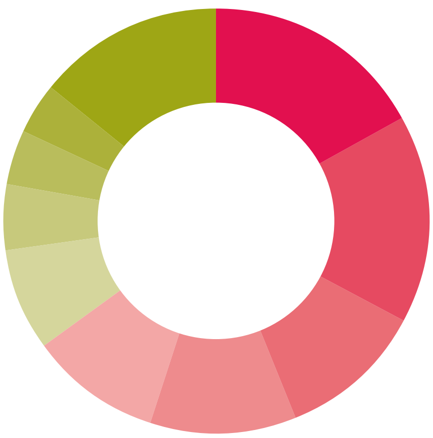
Top M&A sectors: YTD 2013



Top PE deals - YTD 2013

Investor	Investee	Sector	% Stake	US$ mn
Qatar Foundation Endowment	Bharti Airtel Ltd	Telecom	5.00%	1,260
Baring Private Equity Asia	Hexaware Technologies	IT & ITeS	41.80%	400
Blackstone Group, HDFC, Embassy Group	Vrindavan Tech Village	Real Estate	N.A.	367
Partners Group	CSS Corp	IT & ITeS	80.00%	270
Baring Private Equity	Lafarge India	Cement	14.00%	260
Government of Singapore Investment Corporation	Kotak Mahindra Bank	Banking & Financial Services	2.60%	239
Naspers, Tiger Global, Accel Partners, ICONIQ Capital	Flipkart Online Services	IT & ITeS	N.A.	200
TPG Capital	Shriram City Union Finance	Banking & Financial Services	22.65%	194
Blackstone	HCC Real Estate Ltd - 247 HCC Park	Real Estate	N.A.	169
Government of Singapore Investment Corporation	Greenko Group	Power & Energy	N.A.	150

PE sectors: YTD 2013



- IT & ITeS **[17%]**
- Telecom **[16%]**
- Banking & Financial Services **[11%]**
- Real Estate **[11%]**
- Automotive **[10%]**
- Pharma, Healthcare & Biotech **[8%]**
- Power & Energy **[5%]**
- Cement **[4%]**
- FMCG, Food & Beverages **[4%]**
- Others **[14%]**

Private equity

Private equity activity during Q3 2013 remained flat at US$2.1 billion involving 113 deals. However YTD 2013 PE deal values fared better compared to the same period in 2012. There were 15 PE investments worth over US$100 million each during the nine months with four of them coming from the third quarter. Qatar Foundation's US$1.2 billion investment in Bharti Airtel for a 5% stake and Baring Private Equity Asia's US$400 million buyout of a 41.8% stake in publicly listed IT Services firm Hexaware Technologies topped the PE charts for the nine month period.

Final words

India has seemed to somewhat regain her footing in the last few weeks, with the rupee halting its free fall, the capital markets holding at higher-than-worrying-levels, and positive sentiment being infused on account of the appointment of a new RBI Governor. However, the culmination of the cautiously positive sentiment would be in the 2014 general elections, touted to be crucial to changing the country's beleaguered image. India – corporate and otherwise – is bracing itself, while looking ahead.

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Indian economy:
A discouraging outlook

As India's economy moves into the final quarter of 2013, its economic woes continue to grow. The country's Sensex Index has seen significant volatility over the last quarter – as it has in much of the year – and the overall growth expectations for the country have again been lowered.

In early September the Indian prime minister's economic advisory council lowered the growth outlook for the financial year ending 31 March 2014. New forecasts estimate that the country's GDP growth is now only expected to reach 5.3% this year, down from its earlier projection of 6.4%. As reported by the BBC, this new growth outlook is in line with the projections of the country's central bank and many other economists.

These reduced growth expectations follow a slowdown in some of its most important sectors such as manufacturing and natural resources. Furthermore, the country's ineffective monetary policies, as noted a number of times in our economic updates, have led to increasing scepticism as to the country's growth potential from a number of foreign investors. India is now seeing a significant amount of foreign capital being pulled out as investors look for other growth options. India has not been helped in this regard by the growing confidence surrounding the US and UK markets.

The rupee has also been in a state of free fall over recent months. Against the US dollar, the rupee has fallen as much as 20% since May, resulting in higher prices for imported goods. This has ultimately led to higher fiscal and trade deficits. India Ratings & Research, a unit of Fitch Group, has reported that the recent depreciation of the value of the rupee is also likely to increase the oil subsidy to 0.4% of GDP, 0.1% above budget and as reported in India's 'Business Today' this increase in the oil subsidy alone could push the country's fiscal deficit over 5% of GDP.

Analysts however, aren't laying all of the blame of the rupee's decline on the country's recent poor economic performance and output, but are linking it to the shifts, or expected shifts, in the US monetary policy. The expectation being that when policies are tightened in the US, emerging economies see a significant withdrawal of money. These withdrawals can, and are expected to, have a material impact on the progress of India's infrastructure projects – putting further stress on the country's already limited and heavily depreciating infrastructure.

Notwithstanding this and as highlighted previously in our reports, the problem with India's economy is not only its structural issues but huge political hurdles and red tape which have historically and continue to inhibit growth. Inevitably however, with elections due next year and a focus on voters rather than investors, India's incumbent government is unlikely to introduce any new wide ranging economic reforms. The return of the economic growth rates seen pre 2008 are, therefore, unlikely to be realised in the short term.

Nevertheless, President, Mr Pranab Mukherjee, remains confident that the Indian economy will soon return to the high growth trajectory seen previously and that the process of economic reforms has to be continued "with vigour and firmness". The president also noted that crucial legislation changes are currently pending in parliament, demonstrating the determination of policy makers.

Whether the president's words are pure political rhetoric or whether India's economic future can indeed be placed on a firmer footing in the near term, may be dependent to a significant extent on external factors, such as US monetary policy. Notwithstanding this though, for India to create a sustainable platform for growth it is absolutely vital that it starts seeing the impact of its own economic reform.

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Joint ventures between Indian and UK companies - the dos and don’ts

Joint ventures (JV) between UK and Indian companies can be the start of a successful entry into the Indian market. It can also be the beginning of a difficult journey if things go wrong. We have set out some of the dos and don’ts when it comes to Indian JVs from our experience of advising UK businesses with their JV arrangements.

Do:

- Be patient, agreeing a JV terms can take time and may not always be the priority action of the Indian partner. The process may also involve numerous trips to a notary in the UK
- Research, picking the right Indian partner is crucial. You need to ensure that the partner has the same ambitions, vision and working culture to make it a successful relationship. The Indian partner does not necessarily have to be in the same sector as your business to make it succeed but must have the things you do not have i.e. an Indian network, distribution chain, business reputation and contacts. Financial, legal, commercial and reputation due diligence is key
- Visit your potential partner and get an understanding of their business. Make sure you are familiar with the JV partner’s business and get to know their key promoters. Ensure that you are dealing with the decision makers at all stages in the process
- Ensure that you have a well drafted dispute resolution provision in the JV agreement such as an international arbitration provision (to be adjudicated in Singapore or London for example). A dispute in the Indian courts can commonly take a decade to resolve
- Have an exit strategy in case things go wrong or if you want to go it alone in India.

Don’t:

- Allow a JV company to use your IP without an appropriate license so that your company retains ownership of it at all times
- Be put off doing business in India by businesses that express interest and enthusiasm but then don’t respond to your calls or emails when you get back. Finding a suitable partner can take time
- Enter into a JV with a company where there is a wide disparity between funding capabilities. This can cause problems as the JV company looks to expand
- Underestimate the bureaucratic hurdles at both state and national level. Ensure your JV partner has established links in this area as this is not something that you should be getting involved in
- Forget to reserve Bank of India clearance as a non-resident shareholder
- Allow the Indian partner to fully control the JV company. Have a representative on the ground or visit regularity and ensure the decisions requiring the consent of both parties in the JV agreement are well defined and sufficiently protect your interests
- Give too much weight to a non-compete clause in a JV agreement. They are largely unenforceable in India.

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Irwin Mitchell’s India Business Group advises Indian companies operating or looking to invest outside India through our offices in the UK and our best friend law firms who are members of our international network. We also deliver commercial advice for UK and International corporates investing or wishing to do business in India through our project management approach and our contacts with leading law firms in India.

2013 India Companies Act: What's new?

The new Companies Act, 2013 was enacted on 29 August 2013 and has the potential to affect UK companies with subsidiaries in India. The Act aims to improve corporate governance, simplify regulations, enhance the interests of minority investors and for the first time legislate the role of whistle-blowers.

The 2013 Act provides an opportunity to make India's corporate regulations more contemporary, as well as potentially make India's corporate regulatory framework a model to emulate for other economies with similar characteristics.

The new law will replace the nearly 60-year-old Companies Act, 1956. There are over 300 places in the 2013 Act where rules are being prescribed, and are currently available for public comments.

The 2013 Act intends to promote self-regulation and has also introduced some progressive concepts like One-Person Company, Small Company, Dormant Company, E-governance etc. The concept of Corporate Social Responsibility has also been introduced to encourage socially, environmentally and ethically responsible behavior by companies.

Further, the Act seeks to fortify investor protection and transparency by introducing terms like Insider Trading, Price Sensitive Information, Class Action Suits and other additional disclosures. It also intends to give greater responsibility to the auditors and to widen their role.

The Act of 2013 is aimed at building a smooth and easy corporate environment along with the new and improved measures of strong investor protection norms and presents a model for other economies with similar characteristics to emulate.

Some of the salient features of the new Companies Act, 2013:

Governance

- At least one woman director
- At least one India resident director
- Roles and responsibilities of an Independent director (ID) are now legislated
- Database of IDs to be maintained; companies may select IDs from this database
- One-person company permitted (unlike the minimum two previously)
- Maximum directors increased to 15; additional directors only through special resolution
- Maximum 20 directorships per person; 10 public companies
- Stakeholders Relationship Committee introduced
- Mandatory appointment of Key Management Personnel (KMP)
- Directors are now responsible for design and operating effectiveness of internal financial controls
- Significantly enhanced penalties for directors

Financial statements and auditors

- Consolidated financial statements are mandatory for all groups, including listed and private companies, with more than one entity, including associates or joint ventures
- Mandatory rotation of audit firm for all companies post 10 years, except for small and one person companies
- Financial year for all companies to be March 31 (exception for subsidiaries of foreign entities)

- Re-casting and re-statement of financial statements can be ordered; voluntary revision of financial statements for previous periods now permitted
- Auditor to report on adequacy of internal financial control systems and the operating effectiveness of such controls
- Increased restrictions on non-audit services provided by auditors
- Auditor to be a whistle-blower to central government, if aware of fraud
- Maximum limit of 20 companies per partner in an audit firm
- Prescribed companies to appoint internal auditor; manner, period and reporting to be prescribed by the central government
- Significant enhancement of penalties for auditors

Mergers and restructuring

- Restriction on multi layered structures (certain exemptions to foreign acquisitions to comply with law)
- Mergers without tribunal approval permitted between two small companies or between a holding company and its wholly-owned subsidiary
- Merger into foreign companies introduced
- Valuation report is mandatory along with notice to concerned parties in case of proposed mergers
- Scheme of compromise or arrangement must be in line with accounting standards
- In the case of 'reverse merger' of a listed company into an unlisted company, the transferor may continue to be unlisted
- It is prohibited to hold treasury shares directly or through a trust

Other miscellaneous provisions

- Two percent of the average net profit of the preceding three financial years to be spent annually on Corporate Social Responsibility (CSR); for companies with net worth of Rs 500 crore or more, turnover of Rs 1,000 crore or more, or net profit more than Rs 5 crore
- Valuations for any property, stocks, shares, goodwill or any other assets, net worth of a company, etc must be performed by a registered valuer
- Class action suits introduced as a remedy for small investors against wrongful acts
- Establishment of a National Financial Reporting Authority (NFRA), with the objective of monitoring and enforcing compliance of auditing and accounting standards
- Establishment of vigil mechanism (whistle-blowing) in the prescribed manner by every listed company
- Deposit accepted (including interest due) to be repaid within one year from enactment or from due date of such payments, whichever is earlier

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About Grant Thornton UK LLP

Grant Thornton UK LLP established a dedicated South Asia Group in 1991 to serve Asian owned businesses in the UK as well as those investing into and from the Indian subcontinent. We are proud to be one of the first UK accountancy firms to focus on this region.

We are widely recognised as one of the leading international firms advising on India-related matters and have been in involved in every IPO involving an Indian company on AIM, with the exception of the real estate sector.

For those clients requiring advice in both the UK and India we offer a seamless service building on the already strong and close relationship between Grant Thornton UK LLP and Grant Thornton India.

About Grant Thornton India LLP

Grant Thornton India LLP is one of the oldest and most prestigious accountancy firms in the country. Today, it has grown to be one of the largest accountancy and advisory firms in India with nearly 1,000 professional staff in New Delhi, Bangalore, Chandigarh, Chennai, Gurgaon, Hyderabad, Kolkata, Mumbai and Pune, and affiliate arrangements in most of the major towns and cities across the country.

The firm's mission is to be the adviser of choice to dynamic Indian businesses with global ambitions – raising global capital, expanding into global markets, adopting global standards or acquiring global businesses.

International and emerging markets blog

As part of our commitment to remaining at the forefront of changes and developments in regards to UK-India relationship we will be using this space to post original thought leadership and research relevant to the industry. The idea is to encourage discussion around these issues and to open up new areas and debate.

To participate:
www.grant-thornton.co.uk/thinking/international-markets

More information about our South Asia Group can be found at:
www.grant-thornton.co.uk/sectors/emerging-markets/south-asia

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